

# SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Knight Analyst: John Pavalasky Bill Number: SB 935

Related Bills: See Prior Analysis Telephone: 845-4335 Amended Date: April 24, 2003

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Exclusion/Gain From Sale Of New, Direct, Long-Term Investment In Stock Of Small Corporation

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 21, 2003.
- ☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- ☒ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 21, 2003.
- ☒ FURTHER AMENDMENTS NECESSARY.
- \_\_\_\_\_ DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.
- ☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 21, 2003, STILL APPLIES.
- ☒ OTHER - See comments below.

## SUMMARY

This bill would exempt from tax gain from the sale of stock (held for three or more years) acquired directly from any corporation having \$300 million or less of paid in capital.

## SUMMARY OF AMENDMENTS

The April 24, 2003, amendments resolve the policy and technical concerns and one of the implementation issues in our analysis of the bill as introduced February 21, 2003, as follows:

- The holding period for the stock was amended to clarify that the definition of "long-term" means stock held for three years or more.
- The date used to determine whether the direct investment is in a "small corporation" (i.e. \$300 million or less of paid in capital) would be either the date the stock is issued or the date the stock is sold.
- The bill was amended to target the credit to California businesses by requiring that at least 80% (by value) of the assets of the corporation must be used by that corporation in the active conduct of one or more qualified trades or businesses in California during the entire period that the stock is held by the taxpayer.

Board Position:

\_\_\_\_\_ S \_\_\_\_\_ NA \_\_\_\_\_ NP  
\_\_\_\_\_ SA \_\_\_\_\_ O \_\_\_\_\_ NAR  
\_\_\_\_\_ N \_\_\_\_\_ OUA ☒ PENDING

Legislative Director

Date

Brian Putler

5/30/03

Except for the changes discussed above, the remainder of the previous analysis of the bill as introduced February 21, 2003, still applies. The remaining IMPLEMENTATION CONSIDERATIONS are restated below and a new REVENUE ESTIMATE is provided.

### IMPLEMENTATION CONSIDERATIONS

This bill uses terms that are undefined, i.e., “equity share,” and “investment in the stock of a small corporation.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this exclusion.

The April 24, 2003, amendment language adding the active business requirement provides that “assets of the corporations are used by that corporation in the active conduct of one or more qualified trades or businesses” implies that not all trades or businesses in CA are “qualified.” It appears that the word “qualified” should be stricken on page 2, line14, and on page 3, line 3.

### **ECONOMIC IMPACT**

#### Revenue Estimate

This amendment is projected to result in revenue losses as follows:

| Estimated Revenue Impact of SB 935<br>As Amended April 24, 2003<br>Effective with Stock Issued After Enactment Date*<br>\$ Millions |         |         |         |         |
|---|---------|---------|---------|---------|
| 2003-04   | 2004-05 | 2005-06 | 2006-07 | 2007-08 |
| -\$0  | -\$0    | -\$5    | -\$20   | -\$40   |

\* Assumed for this analysis to be August 1, 2003.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

#### Revenue Discussion

For purposes of this estimate it is assumed that this bill would be enacted by 8/1/2003. Thus, the first taxable year to be impacted by this bill is 2006, when the stocks purchased during the 8/1/2003-12/31/2003 period meet the three-year holding period requirement.

The revenue impact of this bill is estimated as the product of the amount of stock gains realized, the fraction of these gains qualified under this bill, and the applicable marginal tax rate.

Using that formula, the revenue loss for the 2006 taxable year is estimated at \$7 million (\$50,000 million stock gains x 0.15% qualifying fraction x 9% tax rate = \$7 million). This 2006 taxable year revenue loss of \$7 million, when restated on a 2005-2006 fiscal year basis, results in a \$5 million revenue impact due to the reduction that would be made to the last two estimate payments made during that fiscal year. The first full fiscal year impact is shown in the 2006-2007 estimate.

It is estimated that about 94% of small corporations meet the new California active business requirement contained in the bill as amended April 24, 2003. The original estimate of \$5 million, \$25 million, and \$45 million for the above fiscal years is therefore reduced by 6% and rounded to the nearest \$5 million.

The revenue impact of this bill would be greater in later years as more and more stocks qualify, reaching a revenue loss of about \$100 million in 2010.

## **LEGISLATIVE STAFF CONTACT**

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